

INSIDE THIS ISSUE:

It's the Economy.. p.2

Prognostications p.3

KEY TAKEAWAYS

⇒ *The market is being driven higher by new money, not better fundamentals*

⇒ *Don't let the media fool you*

⇒ *Big stocks can be as risky as small ones*

⇒ *The experts really don't practice what they preach*

⇒ *This industry is under major accumulation*



KEY STATISTICS

<u>Index</u>	<u>Close</u>	<u>2013</u>
DJIA	14,010	6.9%
S&P 500	1513	6.1%
NASDAQ	3179	5.3%
Russell 2K	911	7.3%

(figures are rounded)

It's All Your Fault

The market continues to rock. It is unbelievable. What is wild is that it is rising despite some not-so-hot economic news and so-so earnings news. So why is the market up a stunning 6.9% on the Dow Jones and 7.3% on the Russell 2000 after a little over a month?

I will tell you. It is because of you. It is all your fault that the Dow is at its highest since 2007 and it could come back to bite us all in the butt later.

We talked about this in late December and early January. We noted that the market would rock after the fiscal cliff crap was put to temporary rest and that we could see strong inflows into equity mutual funds.

We did not realize it would be so off the hook, however. Long-term funds, which exclude money-market vehicles, attracted \$64.8 billion in the first three weeks of the month, according to the Investment Company Institute. The previous record was \$52.6 billion for all of May 2009. Equity mutual funds gathered \$29.9 billion in January's first three weeks, more than for any full month since 2006.

Much like we forecasted a big rise in the market, we noted that the inflows would require the investment pros and managers to put a lot of money to use, but would be followed by a drop, once the inflows subsided. That is likely to happen in the next few weeks, since the move is not based on improving fundamentals.

Why? This move is unsustainable, for one. The Dow is up nearly 1,000 points in 5 weeks. Earnings estimates really have not yet moved higher, and there has been no other place to put \$, frankly. Still, it is the economy that could put a damper on things.

(cont'd on next page)

It's the Economy, St*pid

Despite what you read, things are not really that rosy, economically speaking.

First, the Conference Board noted that its consumer confidence index dropped to 58.6 in January, which is down from 66.7 in December and reached its lowest level since November 2011. Second, the U.S. government's first estimate of Gross Domestic Product (GDP) for the fourth quarter of 2012 showed a *decline of 0.1%* versus the consensus expectations of *1% growth*. It may even be even worse than it sounds at first blush. This marks the first GDP contraction we have experienced since the second quarter of 2009, more than 3 years ago. Disappointing earnings, guidance cautious outlooks for some of NASDAQ's key component stocks have also played a role in this subtle groundswell of sentiment shifts.

Frankly, it is a situation such as this that almost makes me want to avoid stocks altogether for a while.

So, what should you do? Now is the time to sell some calls (preferably out of the money) and place some stop-limit orders on stocks in which you have big gains, if you can. We would recommend doing so on half of your stock position, rather than the entire holding, in case we are early in our assessment. It would not be the first time.

On the buy side, if you have a hankering for expanding your equity portfolio, we would strongly recommend you avoid interest-rate sensitive stocks or even dividend payers, as the likely higher inflationary environment looming on the horizon could crush them like they could crush the bond market.

Instead, if you have been monitoring any commodity-related stocks, such as gold, silver, oil, etc. that appear attractive, now may be a good time to dip your toes in the proverbial water. The same thing goes for biotech stocks that may have news pending, as these vehicles have zero correlation with the economy, or even market valuation, for the most part.

Unless we have a sustained equity mutual fund inflow, which is highly unlikely, or earnings appear to be really strong with rising estimates, we see a 2-3% move higher... max. So, take stock...

Prognostications³

It is early February 2013 and we are still seeing a major lack of liquidity in non-listed micro cap stocks. For that matter, there is still largely a lack of liquidity in a number of listed stocks as well. What does that portend?

We expect to see an acceleration and a rise in the number of non-listed stocks graduating to NASDAQ and the AMEX. This is a good thing and by mid-year we expect to see the fruits of the labors of a fair number of stocks making this move upstream.



Small biotech stocks have seen a resurgence in volume, interest, and business development success. Look for an acceleration in small firms grabbing investment dollars which will help solidify their status and buoy valuations.

Another sector we like is the small oil and gas segment where we believe that the recent and likely continuing move higher will have a positive impact on the space.

While valuation doesn't seem to be particularly important right this moment, we would start making a list of stocks expecting big EPS gains trading below their growth rates. Outperformance could provide some good buys in the spring.

Debt ceiling talk and unrest abroad could stymie the market, in addition to the economic issues we reviewed earlier. At the end of the day, avoid bonds at all costs and don't mess with these new, active ETF's until a track record is developed. You can make more money chasing stocks or other ETFs, with less risk.

Hats off to my Ravens for winning Super Bowl XLVII. However, for all you "bandwagoners," this is probably the high water mark in the near term for the team. Just like we should not expect this to be the start of a dynasty of potentially successive Super Bowl wins, investors should not believe that winners today will be anything beyond short term wins, tomorrow.

Until next week...



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1498 Reisterstown Road, Suite 286
Baltimore Maryland 21208
Phone: 410.609.7100
info@goldmanresearch.com
www.goldmanresearch.com

Analyst: Robert Goldman

Rob Goldman founded Goldman Small Cap Research in 2009. Rob has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

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